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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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Federal Communications Commission
Office of Secretary

In the Matter of	)	
Special Access Rates for Price Cap Local Exchange Carriers	)	WC Docket No. 05-25
AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services	)	RM-10593

COMMENTS OF NEXTEL COMMUNICATIONS, INC.

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Nextel Communications, Inc. (Nextel) submits these comments in response to the Notice of Proposed Rulemaking issued by the Commission in the above-captioned proceedings.[1]

I. INTRODUCTION AND SUMMARY

The record in this proceeding already contains substantial evidence that the special access rates of the Bell Operating Companies (BOCs) are excessive and must be reduced. The record also contains substantial evidence that the Commission's pricing flexibility rules have resulted in price caps on BOC special access services being relaxed in areas where the BOCs continue to possess market power.

In view of this evidence of the BOCs' persistent dominance of special access, their staggering rates of return, and their continuing productivity increases, the Commission clearly needs to adopt interim measures to reduce the BOCs' excessive

[1] *Special Access Rates for Price Cap Local Exchange Carriers*, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994 (2005) ("*NPRM*" or "Notice").

special access rates while this proceeding is pending.[2] Nextel proposes that the Commission implement the following measures to address special access price cap rates and pricing flexibility as quickly as possible and, in any event, no later than January 1, 2006:

Price Cap Rates

- Require the BOCs to adjust their price cap indices to the levels that would have resulted if they had applied a 5.3 percent X-factor, net of inflation, in their 2004 and 2005 annual access tariff filings. These adjustments would address the fact that the BOCs currently have no regulatory obligation to share their substantial annual productivity gains with their customers and face no competitive pressure to pass such savings through. On a going forward basis, the BOCs should be required to continue to use the 5.3 percent X-factor in the 2006 and future annual access tariff filings until a new X-factor is adopted.

Pricing Flexibility

- Adopt new standards, on an interim basis if necessary, for the grant of special access pricing flexibility to ensure that pricing flexibility is permitted only in areas where customers have realistic alternatives to the BOCs for special access services. Since most special access services today are provided under pricing flexibility, it is imperative that the Commission promptly act to correct the most serious shortcomings in those rules. As one possible interim approach, the Commission could use the competitive

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2 *See NPRM* ¶ 131.

"triggers" adopted in the *Triennial Review Remand Order* (*UNE TRRO*)[3] to assess whether competitive LECs would be impaired if they were denied access to unbundled loops and dedicated transport. Under this approach, the BOCs would continue to have special access pricing flexibility for channel terminations and channel mileage (interoffice transport) only in those offices where the BOCs can demonstrate that they are not required to provide access to loops and dedicated transport, respectively, of comparable capacity as unbundled network elements. This approach (and perhaps other alternative approaches proposed in this proceeding) would provide meaningful relief on an interim basis while the Commission develops more refined standards for assessing the competitiveness of the relevant product and geographic markets.

None of the foregoing measures addresses the fact that special access prices are currently at inflated levels. The BOC cost and revenue data show that over the past several years BOC special access revenues have grown much more quickly than expenses and that net investment actually has declined. To address this problem, Nextel further proposes that the Commission require the BOCs to file with their 2006 annual access tariff filing special access rates that are based on forward-looking cost studies. The Commission should fulfill its long-standing commitment to move special access rates to those levels. Alternatively, if a BOC wished to avoid the time and expense of conducting a forward-looking cost study, the Commission could give BOCs the option of retargeting their special access earnings to a level that would not exceed a rate specified by the Commission. For this purpose, the Commission could use the 11.25 percent rate of

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[3] *Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Order on Remand, 20 FCC Rcd 2533 (FCC 04-290) (2005) ("*UNE TRRO*").

return, the last interstate rate of return that the FCC prescribed, or a lower rate that is more reflective of current conditions in capital markets.

All of the foregoing proposals for interim and longer-term relief are needed because the BOCs continue to possess market power in the provision of most special access services. Neither the Commission's price cap regime nor competition today constrains the BOCs from using that market power. Hence, the Commission's obligation in this proceeding is to put in place a regulatory regime that will prevent the BOCs from exercising that power unless and until competitive forces are sufficiently strong to erode the BOCs' market power and constrain their special access rates.

The starting point for a competitive assessment of special access should be reasonable definitions of the relevant geographic and product markets. A Metropolitan Statistical Area (MSA) is much too large a geographic area for assessing competitive conditions, since those conditions can vary widely within a particular MSA, as the Commission itself previously has concluded. Further, the Commission's analysis must take into account both the different types of special access services (channel terminations, channel mileage or interoffice transport, and entrance facilities) as well as the differences in the types of facilities that may be used to provide those services, since both factors affect the prospects for competitive entry.

The dominance of the BOCs in the provision of special access is evident from the enormous earnings they continue to report. In addition, the BOC cost and revenue data indicate that their revenue growth is outpacing their expense increases by a substantial margin and that net investment is declining. All of these trends suggest that in addition to the remedial steps described above, the Commission needs to adopt a new X-factor that

reflects the BOCs' more recent productivity performance, restructure its rules to separate DS1 and DS3 services from other special access services, and implement more refined and reliable standards for determining when to grant pricing flexibility.

II. BACKGROUND

Nextel today remains heavily dependent on special access services offered by the BOCs to provide connections within Nextel's own network, as well as connections between Nextel's network and those of other carriers, such as the interexchange carriers that provide wholesale long distance service to Nextel. Nextel obtains special access service from the BOCs by purchasing service under price cap and pricing flexibility optional pricing plans.

Nextel has constructed its network by using DS1 circuits to interconnect its thousands of cell sites to switching offices. In BOC service areas, the vast majority of these DS1 channel termination circuits terminate in BOC central offices. Nextel also uses DS1 circuits to provide connections to 911, Directory Assistance, incumbent local exchange carrier (LEC) tandems and interexchange carriers as well as local interconnections.[4]

In addition to its extensive use of DS1 channel terminations, Nextel uses primarily DS3 circuits to carry its traffic between BOC central offices and points where traffic from multiple central offices is aggregated, such as another central office or an access tandem. These circuits are generally leased from the BOCs as DS3 channel mileage special access services.

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[4] These DS1 circuits, unlike those connecting cell sites to BOC central offices, are usually ordered as DS3 facilities and provisioned as DS1 circuits. Nextel also purchases a relatively small number of local interconnection facilities out of intrastate tariffs.

Nextel uses high-capacity OCn fiber rings to interconnect aggregation points within a geographic area and to interconnect Nextel's network with interexchange carrier facilities. Nextel uses both BOC as well as non-BOC fiber rings for these high volume transmission links.

III. THE BOCS REMAIN DOMINANT IN THE PROVISION OF SPECIAL ACCESS SERVICES

The Commission commenced this rulemaking proceeding to ensure that its regulation of special access "will allow the market to determine rates where competitive market forces exist, while protecting special access consumers from unreasonable rates where competition is lacking."[5] The extensive record compiled in response to the AT&T Petition for Rulemaking demonstrates that the current regulatory regime has not accomplished these goals.

As noted, the Commission's current price cap rules do not require the BOCs to share any of their substantial productivity gains in providing special access service, and, thus, fail to protect consumers from unreasonable rates in areas where the lack of competition is indisputable. Further, the experience of the past five years has shown that the Commission's pricing flexibility rules provide the BOCs relief from rate regulation and grant them wide discretion to set prices in areas where they are not constrained by the presence of competing providers. Contrary to the Commission's confident prediction in 1999, in MSAs where BOCs have obtained Phase II relief, "almost all special access

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5 *NPRM* ¶ 24.

customers" do not "have a competitive alternative."[6] Rather, the BOCs continue to exercise market power in the provision of special access services.

A. The Relevant Geographic and Product Markets

1. Geographic Market

An assessment of the BOCs' dominance over special access should begin with proper definitions of the relevant markets. The Commission has concluded repeatedly that markets for exchange access services like special access are "point-to-point" markets or markets of "discrete local areas."[7] The fact that there may be competing providers offering dedicated circuits between customer premises and BOC central offices at other locations in an MSA is of no help whatever in addressing Nextel's need for a circuit to connect a cell site with a central office.

The relevant geographic market for special access, therefore, is the geographic area served by a route connecting the two points that a purchaser seeks to link with the dedicated facility (*e.g.*, cell site and central office, or central office and access tandem).[8] Under this approach, the relevant geographic market is defined at the wire center level. This is consistent with the FCC's recent decision in the *UNE TRRO*, in which the Commission defined the geographic market for loops as the wire center serving a

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6 *Access Charge Reform*, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221, ¶ 142 (1999) ("*Pricing Flexibility Order*").

7 *Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.*, Memorandum Opinion and Order, 13 FCC Rcd 18025, ¶ 166 (1998); *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace*, 12 FCC Rcd 15756, ¶ 67 (1997) ("*ILEC In-Region IXC Order*").

8 *ILEC In-Region IXC Order* ¶ 65 n.176.

particular customer's premises and defined the geographic market for dedicated interoffice transport as the specific route connecting two wire centers.[9]

In contrast, an MSA, which the FCC in the *Pricing Flexibility Order* selected as the relevant geographic area for granting pricing flexibility for special access services, covers far too large an area.[10] The record in this proceeding already shows that competitive conditions vary widely within a single MSA.[11] Moreover, the FCC expressly rejected the use of MSAs as the relevant geographic market for both dedicated transport as well as high capacity loops in the recent *UNE TRRO*.[12] The Commission, instead, adopted a narrower market definition based on wire centers that takes into account routing, line density and the number of fiber-based collocators in each wire center.[13]

2. Product Market

The relevant product markets for special access are: a) special access channel terminations (loops) between a BOC's end office and a customer's location (including, in Nextel's case, cell sites); b) special access channel mileage (dedicated interoffice transport) between two BOC offices; and c) entrance facilities between a BOC's wire center and a competitive carrier's point of presence or mobile switching center. Each of these services satisfies a different need for Nextel and other carriers seeking to design

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9 *UNE TRRO* ¶¶ 78-79, 155.

10 *Pricing Flexibility Order* ¶¶ 72-74.

11 *See, e.g.*, Reply Comments of WorldCom, Inc. at 9-10 (Jan. 23, 2003) ("WorldCom Reply"); Reply Declaration of Dr. Lee Selwyn, ¶ 20, attached as Exhibit 3 to Reply Comments of AT&T Corp. (Jan. 23, 2003) ("AT&T Reply"). (Unless otherwise indicated, all comments cited herein were filed in RM No. 10593.)

12 *UNE TRRO* ¶¶ 82, 155, 164.

13 *Id.* ¶¶ 66, 163.

their networks efficiently. These are different special access products that are supplied in different locations and are not substitutes for one another from the perspective of customers. Moreover, the Commission has previously recognized that the economics of deploying each type of facility, and therefore the prospects for competitive entry, vary significantly. For example, the Commission has concluded that the economics of constructing channel terminations (loops) create "substantial" barriers to entry.[14] Thus, the fact that a firm has deployed a competing interoffice transport facility between two BOC offices says nothing about the prospects for the construction of a competitive DS1 channel termination between a specific cell site and a specific central office.[15] Moreover, DS1 and DS3 circuits generally, and along less dense routes in particular (such as cell-site-to-central-office) are not effective substitutes for one another and should be analyzed separately.

B. Nextel Rarely Has Access to Realistic Competitive Alternatives to the BOCs for Special Access Service

The most important question in assessing the state of competition for special access is whether users typically have an alternative to the BOCs' offerings. Nextel's own experience is consistent with the evidence previously filed in this proceeding: Special access users continue to lack competitive alternatives to the BOCs' special access services. Nextel leases from the BOCs thousands of DS1 channel terminations that connect its individual cell sites with BOC central offices. The market for these circuits is particularly resistant to competitive entry.

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14 *Id.* ¶ 153.

15 Along less dense transport routes, an increase in the price of DS1 service is not likely to lead purchasers to substitute DS3 service.

As the Commission recently acknowledged, "competitive deployment of stand-alone DS1-capacity loops is rarely if ever economic."[16] Thus, for carriers like Nextel that rely heavily on DS1 channel terminations, the prospects for obtaining service from competing providers are extremely limited. In Nextel's case, this problem is exacerbated by the fact that – for zoning and other reasons – cell sites frequently are located in out-of-the way locations, such as roadsides. The deployment of channel terminations to cell sites typically requires right-of-way approvals as well as tail-end special construction. It is highly unlikely that a competitive provider would find it economically attractive to build individual, stand-alone DS1 circuits to serve these remote sites, which are frequently located far from the core urban areas where competitors usually concentrate their facilities.[17] In addition to the limited revenue opportunity associated with stand-alone DS1s, a competing provider would also face the risk that if Nextel subsequently were to opt for a more favorable offer from the BOC, the facility could not be used to serve any other customer and, hence, the investment would be a total loss. Furthermore, alternative technologies, such as fixed wireless or a cable-provided circuit, rarely meet Nextel's service requirements.[18]

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16 *UNE TRRO* ¶ 166.

17 *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978, *as modified by* Errata, 18 FCC Rcd 19020, ¶ 205 (2003) ("*UNE TRO*") (explaining that "economies of scale in deployment can accrue in constructing loops to locations that are geographically close to a carrier's transport network" particularly in urban areas where the concentration of potential customer locations is very dense and that "[c]onversely . . . loops are more expensive to build in rural areas.").

18 *See, e.g.*, Competition in Access Markets: Reality or Illusion, A Proposal for Regulating Uncertain Markets at 22-24 (ETI Aug. 2004) ("ETI Report"), attached to *Ex Parte* Letter from Colleen Boothby, counsel for Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, FCC, RM No. 10593 (Aug. 26, 2004).

The record compiled in this proceeding is consistent with Nextel's experience.[19] As AT&T has explained, the deployment of alternative channel terminations is almost never cost-justified, meaning that the BOC "almost always has a monopoly over at least the channel termination link."[20] Thus, special access purchasers "generally have *no* alternative suppliers for the bread and butter DS-level services."[21] The Ad Hoc Telecommunications Users Committee also has filed data showing that the BOCs remain the sole source of dedicated access at roughly 98% of all business premises nationwide, even for the largest corporate users.[22] In addition, Ad Hoc's analysis shows that intermodal technologies do not offer competitive alternatives to high speed special access services.[23] In fact, it appears to be undisputed that competitive alternatives are available only at a "tiny percentage" of commercial buildings.[24] Even in the most competitive markets, non-incumbent LEC alternatives are available for less than 15% of all

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19 *See* AT&T Reply at 12-16; ETI Report at 16-22.

20 AT&T Reply at 11.

21 *Id.* (emphasis in original).

22 ETI Report at 11-26; Reply Declaration of Susan M. Gately, ¶ 18, attached to Reply Comments of Ad Hoc Telecommunications Users Committee, WC Docket No. 05-65 (May 10, 2005) ("Gately Declaration").

23 Gately Declaration ¶¶ 19-25.

24 AT&T Reply at 13 (stating that the BOCs do not dispute the conclusion that competitive alternatives are available only in a small number of buildings).

buildings.[25] This dearth of competitive alternatives is most pronounced for the lowest capacity circuits, [26] and for locations outside of core urban areas.

C. The BOCs' Excessive Earnings Since 2000 Provide Further Evidence That Special Access Rates Are Unlawful

Basic economics teaches that competitive markets drive prices toward incremental costs. As a result, firms in such markets expect in the long term to earn revenues that recover their costs of providing service, including the cost of attracting debt and equity capital. Firms with market power, by contrast, can sustain prices at levels that will produce profits that far exceed their costs by restricting the availability of service.

AT&T's comprehensive study of BOC special access rates, filed late last year as an *ex parte* submission in support of its petition, provides compelling evidence that special access prices in areas where the BOCs have been granted pricing flexibility have not been driven down by competition. AT&T analyzed BOC rate changes for DS1 and DS3 services from May 1, 2001 to August 31, 2004, and obtained the following results: 1) price cap rates generally fell during the period, although not significantly below the maximum allowable rates under the CALLS Order, and 2) pricing flexibility rates on average remained the same or increased during the period. As AT&T pointed out, maintaining rates at 2001 levels in the face of declining special access costs over the period is tantamount to increasing prices.[27]

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[25] *Id.* at 14-15 (citing figures from Sprint Long Distance and from Cable & Wireless indicating that competitive alternatives are available in only 7 to10 percent of buildings served by those carriers).

[26] *Id.* at 15 ("AT&T remains critically dependent upon the Bells for . . . virtually all of its DS1 purchases."); *id.* at 11 ("competitors almost never provide alternatives for customers served at the DS1 level").

[27] Declaration of M. Joseph Stith (Oct. 18, 2004), attached to Letter from David L. Lawson, Counsel for AT&T Corp., to Marlene H. Dortch, FCC Secretary, RM No. 10593

Moreover, the BOCs' own data show that they are earning exorbitant profits from the provision of special access. These data also demonstrate that the growth in the revenues of BOC special access has consistently exceeded their increases in expenses, which is reflected in the increasing margins earned by the BOCs on these services. There is no evidence that these higher margins and returns are required to attract capital, compensate for new risks, or reward innovative efforts.

Automated Reporting Management Information System (ARMIS) data for 2004 show that the special access rates of return reported by SBC, Qwest and BellSouth amounted to 76%, 77% and 82% respectively.[28] Even Verizon, which historically has lagged behind the other BOCs, reported a return of 32%. These returns are not an aberration – special access rates of return for each BOC have grown steadily over the past five years. Indeed, SBC's rate of return rose by more than 80% over that period, and the rates of return for the rest of the BOCs increased by more than 100%.[29] Moreover, one study suggests that even these astronomical returns may understate the BOCs' earnings. According to this analysis, the costs of other services may have been misallocated to the special access category, thereby overstating the BOCs' special access costs and understating their rates of return.[30] Without effective price cap rules or

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(Dec. 7, 2004), also attached as Attachment E to Reply Comments of AT&T Corp., WC Docket No. 04-313 (Oct. 19, 2004) ("Stith Declaration").

28 *See* attached Exhibit A.

29 *Id.*

30 *See* ETI Report at 33-34 (noting that the net investment allocated to the special access category is "completely disproportionate" to the number of special access loops as a percentage of loops in service, raising "suspicions that costs are being *overallocated* to the special access category.") (emphasis in the original); Gately Declaration ¶ 12.

meaningful competition to slow their ascent, the BOCs' prices and earnings are likely to grow at an even faster pace in the future.

The magnitude of the BOCs' windfall from special access is enormous. In 2004, the revenue difference between the BOCs' actual reported earnings and the earnings they would have achieved if they had been subject to an 11.25% return on investment, the most recent rate of return that the Commission authorized for cost-of-service incumbent local exchange carriers, amounted to more than $6.3 billion.[31] That cost is borne by the BOCs' customers and competitors that must rely on special access, and ultimately by the end-user customers of Nextel and other carriers that depend on special access as a critical input to their services. By maintaining their prices at artificially high levels, the BOCs restrict the output of special access below that which a competitive market would produce and raise the costs of their rivals that depend on these services.

Since adopting the original ARMIS rules in 1987,[32] the Commission has repeatedly relied on those data in making regulatory determinations. Under the original price cap rules, for example, carriers were subject to sharing obligations if their rate of return, computed in accordance with the ARMIS rules, exceeded specified levels. Similarly, carriers determined their eligibility for a low end adjustment on the basis of whether their rate of return, as calculated in accordance with ARMIS rules, fell below a specified floor.[33] And the BOCs, of course, have endorsed the use of ARMIS data in the

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31 *See* attached Exhibit B.

32 *See Automated Reporting Requirements for Certain Class A and Tier 1 Telephone Companies*, Report and Order, 2 FCC Rcd 5770, ¶ 1 (1987); Order on Reconsideration, 3 FCC Rcd 6375, ¶ 1 (1988).

33 *See, e.g., 2000 Biennial Regulatory Review – Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase II; Amendments to the Uniform System of Accounts for*

past when it has suited their purposes. For example, the BOCs have argued that the Commission should use the "embedded" costs reported in ARMIS to evaluate the reasonableness of regulated rates for unbundled network elements.[34]

Although the BOCs in the past have objected to the use of ARMIS data in evaluating their special access rates of return because of alleged cost allocation issues, the Notice points out that the data reveal an important trend that is not affected significantly by the allocation of costs.[35] Specifically, the ARMIS data provide a reliable measure over time of the relationship between the growth in revenues and the growth in expenses and investment for BOC special access services. The data for the period 2000-2004 show that special access revenues have increased at a significantly higher rate than operating expenses and investment.[36] Specifically, during that period, BOC special access revenues increased by 45%, while total operating expenses grew by 21% and average net investment declined by 12%.[37]

Interconnection; Jurisdictional Separations Reform and Referral to the Federal-State Joint Board; Local Competition and Broadband Reporting, Report and Order In CC Docket Nos. 00-199, 97-212, and 90-286; Further Notice of Proposed Rulemaking in CC Dockets Nos. 00-199, 99-301 and 80-286, 16 FCC Rcd 19911, ¶ 12 (2001); *see also Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786, ¶¶ 120-165 (1990).

34 *See, e.g., Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers,* WC Docket No. 03-173, Comments of United States Telecom Association at 10 (Dec. 16, 2003); Comments of Verizon at 40, 46, 58, 94 (Dec. 16, 2003); Comments of SBC, Exhibit A, "The Economics of UNE Pricing," *prepared by Debra J. Aron and William Rogerson*, at 28-32 (Dec. 16, 2003).

35 *NPRM* ¶ 29.

36 *See* attached Exhibit A.

37 *Id.*

These trends are striking because they indicate that the margins earned by the BOCs have substantially outpaced inflation. In more competitive markets, high margins serve the efficient role of alerting would-be entrants to the substantial demand for special access. The actual (and anticipated) entry of these carriers in competitive markets will reduce the prices paid for and the margins earned on special access to more competitive levels. The ARMIS trends suggest that price-reducing entry has not occurred and the higher margins are based on the BOCs' market power.

Finally, as AT&T and others have shown, a comparison of BOC special access rates with the unbundled network element (UNE) rates for comparable services further confirms that BOC special access rates are excessive. For example, DS1 channel terminations are comparable to DS1 UNE loops;[38] indeed, carriers generally purchase special access channel termination services as a substitute wherever UNE loops are not available. Nevertheless, the evidence in this and other proceedings demonstrates that the rates for special access services are much higher than the comparable prices for UNE facilities.

An analysis conducted by T-Mobile in connection with the *TRRO* proceeding showed that the prices incumbent LECs charge for special access DS1 channel termination services are approximately twice the prices, on average, for comparable UNE loop facilities.[39] This analysis is consistent with data submitted by AT&T showing that

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38 *See UNE TRO* ¶ 593 & n.1825 (drawing an analogy between a special access channel termination and a UNE loop).

39 *See* T-Mobile Comments, WC Docket No. 04-313, at 22 and attached Declaration of Michael A. Williams at Appendix B (Oct. 4, 2004). Dr. Williams' analysis showed that even UNE prices, though closer to competitive rates than the special access prices, were still substantially higher than the prices a competitive market place would produce. Williams Declaration ¶ 33.

the BOCs' tariffed rates for a typical 10-mile special access circuit (including two channel terminations, a fixed mileage transport charge and a ten-mile channel mileage circuit) are, on average "significantly above their rates for equivalent UNEs" and exceed the UNE rates for a comparable circuit (*i.e.*, loops and transport for a ten-mile circuit) by "well over 100% in many cases."[40]

IV. THE COMMISSION SHOULD REINSTATE EFFECTIVE PRICE CAP REGULATION FOR BOC SPECIAL ACCESS SERVICES AND OVERHAUL ITS RULES GOVERNING PRICING FLEXIBILITY

We have shown above that the BOCs continue to wield market power over special access and are using that power to reap huge profits from their wholesale and end-user customers. We also have shown that the FCC's rules have permitted the BOCs to obtain expansive pricing flexibility in areas where competition does not constrain the prices for special access service. Consequently, it is imperative that the Commission adopt revisions to its price cap rules so that rates in areas where customers do not have competitive alternatives will be set at lawful levels. It is equally important that the Commission replace its existing standards for granting pricing flexibility with new benchmarks that ensure that price cap safeguards are removed only in areas where special access users have access to competitive alternatives. Finally, although these changes to the Commission's regime can ensure that price cap and pricing flexibility rates are just and reasonable on a going forward basis, they do not adequately address the need to reduce existing rates to reasonable levels. Nextel proposes several steps that the Commission can and should take to address those concerns.

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40 Stith Declaration ¶ 2.

A. Effective Price Cap Regulation of Special Access Requires Reinstatement of an Appropriate X-Factor and Reform of the Rules Governing Baskets and Bands

The X-factor has been an essential element of the Commission's system of price cap regulation. The elimination of traditional rate base, rate-of-return regulation was intended to strengthen the BOCs' incentives to reduce their cost of providing service by allowing them to retain the benefits of their productivity gains.[41]

The X-factor originally was "aimed at capturing a portion of expected increases in carrier productivity, so that these improvements, as under competition, will result in lower prices for consumers."[42] The record in the agency's price cap rulemakings contained studies that analyzed the historical productivity performance of the BOCs. The Commission used those studies to develop the productivity factors that over the years have been used annually to adjust the BOCs' price cap indices downward.

In conjunction with its adoption of the CALLS Plan, however, the Commission departed from that approach. It eliminated the X-factor as a measure of productivity and replaced it with a "transitional mechanism," a 6.5 percent annual adjustment factor.[43] That factor, in turn, was reduced, beginning in the 2004-5 tariff year, to a level that was equal to the annual adjustment for inflation. As a result, since July 2004, the BOCs have been permitted to retain all of the productivity gains that they have realized in providing special access service.

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41 *Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786, ¶ 2 (1990) ("*LEC Price Cap Order*"); *aff'd, National Rural Telecom Ass'n v. FCC*, 988 F.2d 174 (D.C. Cir. 1993).

42 *United States Tel. Ass'n v. FCC*, 188 F.3d 521, 524 (D.C. Cir. 1999).

43 *Access Charge Reform*, Sixth Report and Order, 15 FCC Rcd 12962, ¶ 160 (2000) ("*CALLS Order*").

The *CALLS Order*'s elimination of the annual downward adjustment of the special access price cap indices would have made sense if competition governed the markets in which the BOCs provide service. As the D.C. Circuit noted, in such markets, the structural forces of competition would compel the BOCs and their competitors to pass through productivity gains to their customers in the form of lower prices and/or improved service quality. As demonstrated above, however, the BOCs remain dominant in the provision of special access service. In the absence of an annual downward adjustment to their price cap indices, the BOCs are able to retain all of the benefits of their productivity gains. As the ARMIS data show, the BOCs' growth in special access revenues each year has far exceeded increases in their costs of providing service, resulting in ever-higher margins for the BOCs. The market power unleashed by the introduction of pricing flexibility has led to more of the productivity gains being retained by the BOCs than would be true in a more competitive marketplace.

The returns reported by the BOCs for 2004 buttress this conclusion. Their average rate of return rose to 54 percent, a 10% increase over the average for 2003 and an increase of over 90% from the 2000 average of 28 percent. In sum, as the *NPRM* properly observes, "[t]his record contains substantial evidence suggesting that productivity has increased and continues to increase in the provision of special access services."[44] Instead of these gains being passed through to customers, the BOCs have been permitted to retain the windfall, as reflected by their earnings.

The Commission, therefore, must adopt a new X-factor that approximates the substantial productivity gains that the BOCs have been able to achieve year after year for

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44 *NPRM* ¶ 131.

the past several years. As the Notice indicates, the BOCs' submission of their expense matrix data beginning with 1994 will be a key input into the development of a reasonable X-factor.

The preparation of a credible study quantifying an appropriate X-factor is a complex task that will take time to complete. Clearly, however, the Commission should not wait to reduce special access rates to more reasonable levels. Indeed, the Notice expressly states that because there is currently no requirement that the BOCs share their productivity gains with their customers, the Commission anticipated that, prior to July 1, 2005, it "will establish an interim plan to ensure special access price cap rates remain just and reasonable while the Commission considers the record in this proceeding."[45] The goal of ensuring just and reasonable rates can only be accomplished through reductions in the BOCs' special access rates as soon as possible. To that end, we discuss below a series of steps that the Commission can and should take while it is formulating a longer term plan for special access regulation and pricing flexibility.

The Notice seeks recommendations for restructuring special access baskets and bands under price cap regulation. The Commission traditionally has placed like services in a single basket in order to limit the ability of a BOC to set prices for competitive and non-competitive services in an anticompetitive manner.[46] The various approaches to categorization discussed in the Notice generally would achieve greater segregation of the less competitive special access services, thereby limiting the ability of price cap LECs to charge unreasonably high rates. Nextel supports this objective and recommends that the

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45 *Id.*

46 *LEC Price Cap Order* ¶¶ 198-203.

Commission modify the price cap structure to comport with its findings in this proceeding on the state of the market for special access services.

At a minimum, the record supports creating separate and distinct categories or subcategories for DS1 and DS3 channel terminations between the LEC end office and customer premises. Creating a category or subcategory for DSL and other competitive broadband services also would help check anticompetitive pricing practices, while allowing the BOCs reasonable flexibility to adjust prices within the new category in order to compete effectively. The priority ought to be to devise a workable structure that addresses key problems and put it in place quickly.

Restructuring baskets alone is not sufficient to constrain the BOCs' exercise of market power because current special access rates are already excessive. Moving to a new price cap regime will only be effective if, at the same time, rates for non-competitive services are brought down to reasonable levels.

B. The Commission Must Adopt a New Regime to Govern the Grant of Special Access Pricing Flexibility to the BOCs

The past five years have conclusively demonstrated that the criteria used to determine whether the BOCs should be given pricing flexibility for special access services are fundamentally flawed. The geographic markets are much too large and the "triggers" are completely unreliable as surrogates for the availability of competitive alternatives.[47] This is because these triggers only account for the presence of competitive

[47] The leniency of the Commission's pricing flexibility "triggers" exacerbate the problems created by the use of an MSA as the relevant geographic market. As the *NPRM* observes, all of the special access pricing flexibility petitions filed by the BOCs have been based on the "percentage of revenue associated with wire center collocation as opposed to the trigger that measures only the percentage of wire centers with

alternatives without accounting for their competitive significance, by considering line density and specific location, for example. The Commission must replace this scheme with meaningful standards that will ensure that competition in fact will constrain the behavior of the BOCs before they are granted pricing flexibility.

As discussed above, the appropriate geographic market for assessing the availability of competitive alternatives to the BOCs is the route connecting two points. In the case of channel terminations, for Nextel that route principally connects a cell site or other customer premises with an end office. In the case of transport, the relevant market is the route that connects two offices, which could be end offices or tandem switches. The relevant product market is defined by the type of service connecting the two points (*e.g.*, channel termination, interoffice transport) as well as the capacity of the circuit (*e.g.*, DS1 or DS3).

The task of the Commission in fashioning more reliable standards for granting pricing flexibility to the BOCs for special access services is analogous to the analysis it conducted in the *TRRO* in establishing "impairment" standards under section 251 of the Act. The "impairment" standard involves a particular statutory benchmark that involves different considerations from those implicated in a pricing flexibility analysis. In both circumstances, however, a primary consideration is the availability of competitive services from alternatives to the BOCs. Thus, the *TRRO* decision provides a useful reference point for the type of analysis needed to revise the Commission's criteria for granting pricing flexibility to the BOCs without inviting unwarranted price increases.

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collocation." *NPRM* ¶ 89. This suggests that competitive entry, as evidenced by collocation, is concentrated in a limited number of wire centers within an MSA.

In the *TRRO*, the Commission in conducting its "impairment" analysis modified a strict route-by-route analysis to take account of the fact that routes with similar end points and similar revenue opportunities (*i.e.*, circuits with similar transmission capacities) could allow the FCC to make determinations about "impairment" that apply generally to a particular category of routes.[48] The Commission based its adoption of specific impairment standards on its conclusion that they identify the locations where the revenue opportunities for a potential entrant are sufficiently lucrative to justify investment in transport and loop facilities that would compete with the incumbents' offerings.[49]

In that context, the Commission concluded that "requesting carriers are impaired without access to DS1-capacity loops at any location within the service area of an incumbent LEC wire center containing fewer than 60,000 business lines or fewer than four fiber-based collocators."[50] The Commission further found that "requesting carriers are impaired without access to DS3-capacity loops at any location within the service area of an incumbent LEC wire center containing fewer than 38,000 business lines or fewer than four fiber-based collocators."[51]

The Commission followed substantially the same approach in establishing impairment standards for dedicated transport. It concluded that "competing carriers are impaired without access to DS1 transport on all routes for which at least one end-point of the route is a wire center containing fewer than 38,000 business lines and fewer than four

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48 *UNE TRRO* ¶¶ 87-92.

49 *Id.*

50 *Id.* ¶ 146.

51 *Id.*

fiber-based collocators."[52] The FCC further found that "competing carriers are impaired without access to DS3 transport on all routes for which at least one end-point of the route is a wire center containing fewer than 24,000 business lines and fewer than three fiber-based collocators."[53]

The analysis that led to the "impairment" standards adopted for DS1 and DS3 loops and transport is the type of granular analysis that must be undertaken in connection with the establishment of new standards for the grant of pricing flexibility. The Commission should undertake that analysis immediately so that it may promptly adopt new, effective standards to govern the grant of BOC pricing flexibility.

C. The Commission Should Act Promptly to Begin to Reduce Special Access Rates to Reasonable Levels

The Commission should not wait until it completes the reform of its special access price cap regime before it introduces urgently needed measures to begin to reduce special access rates to more reasonable levels. In light of the evidence that existing special access rates are excessive and that BOC productivity gains continue to increase, the Commission should take immediate steps to ameliorate the current circumstances of special access customers.

Specifically, the Commission should promptly begin to reduce existing price cap indices from their existing excessive levels and to implement revised standards for the grant of pricing flexibility, on an interim basis if necessary, to bring within the price cap regime services currently provided in areas where competitive forces do not effectively constrain the BOCs' special access prices. These measures would provide meaningful

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52 *Id.* ¶ 66.

53 *Id.*

interim relief to BOC special access customers and establish a timetable for moving special access rates to reasonable levels.

As an initial step, the Commission should require the BOCs to adjust their special access price cap indices (PCIs) downward to the levels that would have resulted if the BOCs had been required to apply a 5.3 percent X-factor, net of inflation, as of July 1, 2004 and July 1, 2005.[54] This restatement of the special access PCIs should be made effective as quickly as possible and, in any event, no later than January 1, 2006.

The BOCs have been under no obligation to share their productivity gains with their customers since the 2003 annual access filing. The BOCs' earnings and the evidence that growth in their special access demand and revenues consistently and substantially surpasses growth in their expenses clearly indicate that the BOC annual productivity gains have been substantial. Thus, the restatement of the price cap indices would pass through a portion of those gains to customers on a going-forward basis. Moreover, the D.C. Circuit has upheld 5.3 percent as a reasonable X-factor, based on past BOC performance.[55] In view of the continuing productivity gains noted by the Commission, this adjustment is a conservative step in moving special access rates toward reasonable levels. The BOCs should be required to make the same adjustment to their

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[54] Several parties have asked the Commission to require the BOCs to implement a 5.3 percent adjustment to their special access indices in connection with their 2005 annual access tariff filing. *See, e.g.,* Letter from Brian R. Moir, Counsel for eTUG, and C. Douglas Jarett, Counsel for API, to Marlene H. Dortch, FCC Secretary, WC Docket No. 05-25 (May 10, 2005); Letter from Richard M. Rindler, *et al.*, Counsel for ATX Communications, Inc., CTC Communications Corp., Pac-West Telecomm, Inc., US LEC Corp., and US Telepacific Corp. d/b/a US Telepacific, WC Docket No. 05-25 (May 27, 2005). Nextel's request for interim relief is consistent with these earlier requests.

[55] *Bell Atlantic Tel. Cos. v. FCC*, 79 F.3d 1195, 1201 & 1208 (D.C. Cir. 1996).

price cap indices in each future annual access tariff filing until the Commission adopts a new X-factor.

In addition, the Commission should promptly address reform of its existing pricing flexibility rules, if necessary, by adopting interim standards. The FCC's *TRRO* standards applicable to loops and dedicated transport could be a useful interim benchmark. The adoption of interim standards should not slow the analysis needed to adopt more permanent and refined benchmarks. Rather, interim standards would enable to Commission to grant short-term relief to customers in areas where the BOCs continue to be dominant in the provision of special access.[56]

With the adoption of new pricing flexibility standards, the Commission should require the BOCs to identify and list in their interstate access tariffs all of their special access offerings that are currently subject to Phase I or II pricing flexibility that would not be eligible for relief under the new standards. For special access customers to receive the full benefit of the adjustments to the price cap indices, all services subject to price cap regulation on a going forward basis should be placed under price caps no later than January 1, 2006.

Finally, the Commission should use the 2006 annual access tariff filing to fulfill its long-standing commitment to move special access prices to levels that reflect forward-

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[56] *See, e.g., CompTel v. FCC*, 309 F.3d 8, 14-15 (D.C. Cir. 2002) (upholding interim restrictions on the unbundling of EELs); *MCI v. FCC*, 750 F.2d 135, 141 (D.C. Cir. 1984) (upholding FCC's interim freeze of the subscriber plant factor); *ACS of Anchorage, Inc. v. FCC*, 290 F.3d 403, 410 (D.C. Cir. 2002) (upholding FCC's interim jurisdictional classification of ISP-related costs for purposes of advancing a "substantial policy objective"); *see also Unbundled Access to Network Elements*, Order and Notice of Proposed Rulemaking, 19 FCC Rcd 16783, ¶ 20 (2004).

looking costs.[57] Market forces have not done so for the past eight years and will not do so in the foreseeable future. Accordingly, the BOCs should be required to submit with the 2006 annual access tariff filings special access rates based on forward-looking cost studies. These filings should be accompanied by the necessary supporting cost information and submitted on 90 days' notice. In order to ensure uniformity in the manner in which such cost studies are performed, the Commission should adopt basic guidelines concerning the inputs to the studies. Attached to these comments as Exhibit C is a suggested list of such inputs.

Alternatively, if a BOC wished to avoid the time and expense associated with completing such a study, the Commission should permit it to elect to reduce its special access revenues by an amount equal to the amount by which its special access revenues exceeded an earnings level of 11.25 percent. BOCs electing this option would file their 2006-7 annual filing in accordance with the usual filing schedule.

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[57] *See, e.g., Access Charge Reform*, First Report and Order, 12 FCC Rcd 15982, ¶¶ 43, 48 (1997) (implementing rate restructuring to move access charges toward their forward-looking cost levels, and reserving the right "to adjust rates in the future to bring them into line with forward-looking costs" where competition did not emerge); *CALLS Order*, ¶ 57 (providing price-cap LECs a choice between the interim rate-level components of the CALLS plan, or having their rates reinitialized based on forward-looking economic costs).

V. CONCLUSION

For the reasons discussed above, the Commission should reform its existing rules governing the BOCs' provision of special access in accordance with the proposals set forth above.

Respectfully submitted,

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June 13, 2005

Certificate of Service

I, Ruth E. Holder, hereby certify that on this 13th day of June, 2005, I caused a true and correct copy of the foregoing Comments of Nextel Communications, Inc. to be mailed by electronic mail to:

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EXHIBIT A

SELECTED RBOC SPECIAL ACCESS ARMIS DATA (2000-2004)

Company	Item	Y2004	Y2003	Y2002	Y2001	Y2000
BellSouth Corporation	Revenue (000)	$ 2,358,381	$ 2,105,748	$ 2,005,943	$ 1,831,143	$ 1,217,326
	TOE (000)	$ 694,731	$ 663,967	$ 657,588	$ 676,932	$ 494,806
	TPIS (000)	$ 4,221,246	$ 4,088,228	$ 4,009,316	$ 4,005,925	$ 3,338,531
	ANI (000)	$ 1,233,462	$ 1,317,121	$ 1,438,138	$ 1,536,048	$ 1,247,668
	Net Return (000)	$ 1,010,265	$ 910,703	$ 813,076	$ 711,303	$ 458,996
	ROR	82%	69%	57%	46%	37%
Qwest Corporation	Revenue (000)	$ 1,664,028	$ 1,617,593	$ 1,640,723	$ 1,511,057	$ 1,207,860
	TOE (000)	$ 558,515	$ 558,518	$ 566,347	$ 558,249	$ 519,208
	TPIS (000)	$ 3,621,864	$ 3,573,761	$ 3,548,926	$ 3,460,928	$ 2,949,322
	ANI (000)	$ 884,989	$ 1,056,989	$ 1,224,287	$ 1,416,675	$ 1,183,572
	Net Return (000)	$ 680,037	$ 695,931	$ 706,904	$ 633,201	$ 451,357
	ROR	77%	66%	58%	45%	38%
SBC Communications	Revenue (000)	$ 4,287,042	$ 4,256,343	$ 4,254,654	$ 4,294,276	$ 3,400,629
	TOE (000)	$ 1,640,739	$ 1,690,493	$ 1,537,557	$ 1,350,369	$ 1,465,291
	TPIS (000)	$ 9,370,633	$ 9,227,656	$ 9,114,449	$ 8,022,241	$ 7,623,212
	ANI (000)	$ 2,241,800	$ 2,580,329	$ 3,175,416	$ 3,045,731	$ 2,890,702
	Net Return (000)	$ 1,707,981	$ 1,629,850	$ 1,686,481	$ 1,871,335	$ 1,204,031
	ROR	76%	63%	53%	61%	42%
Verizon Communications	Revenue (000)	$ 5,215,859	$ 4,880,301	$ 4,890,345	$ 4,371,777	$ 3,511,901
	TOE (000)	$ 3,007,779	$ 3,104,678	$ 2,647,888	$ 2,526,002	$ 2,394,114
	TPIS (000)	$ 16,332,846	$ 15,803,785	$ 15,020,163	$ 14,281,238	$ 12,687,658
	ANI (000)	$ 4,786,593	$ 5,280,791	$ 5,648,340	$ 5,759,217	$ 5,116,407
	Net Return (000)	$ 1,514,364	$ 1,220,301	$ 1,359,867	$ 1,286,600	$ 780,691
	ROR	32%	23%	24%	22%	15%
RBOC Totals	Revenue (000)	$ 13,525,310	$ 12,859,985	$ 12,791,665	$ 12,008,253	$ 9,337,716
	TOE (000)	$ 5,901,764	$ 6,017,656	$ 5,409,380	$ 5,111,552	$ 4,873,419
	TPIS (000)	$ 33,546,589	$ 32,693,430	$ 31,692,854	$ 29,770,332	$ 26,598,723
	ANI (000)	$ 9,146,844	$ 10,235,230	$ 11,486,181	$ 11,757,671	$ 10,438,349
	Net Return (000)	$ 4,912,647	$ 4,456,785	$ 4,566,328	$ 4,502,439	$ 2,895,075
	ROR	54%	44%	40%	38%	28%

Revenue is from ARMIS 43-01 and is in 000s.
Total Operating Expense (TOE) is from ARMIS 43-01 and is in 000s.
Telephone Plant in Service (TPIS) is from ARMIS 43-01 and is in 000s.
Average Net Investment (ANI) is from ARMIS 43-01 and is in 000s.
Net Return is from ARMIS 43-01 and is in 000s.
Rate of Return (ROR) is calculated by dividing Net Return by ANI.

EXHIBIT B

Excess Interstate Special Access Revenues Earned by RBOCs (2004)

Special Access		
BellSouth	Revenue	$2,358,381
	Average Net Investment	$1,233,462
	Net Return	$1,010,265
	Rate of Return	82%
	Net Return Adjustment	-$871,501
	Income Tax Adjustment	-$557,760
	Revenue Adjustment	-$1,429,261
Qwest Corporation	Revenue	$1,664,028
	Average Net Investment	$884,989
	Net Return	$680,037
	Rate of Return	77%
	Net Return Adjustment	-$580,476
	Income Tax Adjustment	-$371,504
	Revenue Adjustment	-$951,980
SBC	Revenue	$4,287,042
	Average Net Investment	$2,241,800
	Net Return	$1,707,981
	Rate of Return	76%
	Net Return Adjustment	-$1,455,779
	Income Tax Adjustment	-$931,698
	Revenue Adjustment	-$2,387,477
Verizon	Revenue	$5,215,859
	Average Net Investment	$4,786,581
	Net Return	$1,514,339
	Rate of Return	32%
	Net Return Adjustment	-$975,849
	Income Tax Adjustment	-$624,543
	Revenue Adjustment	-$1,600,392
RBOC Total	Revenue	$13,525,310
	Average Net Investment	$9,146,832
	Net Return	$4,912,622
	Rate of Return	54%
	Net Return Adjustment	-$3,883,603
	Income Tax Adjustment	-$2,485,506
	Revenue Adjustment	-$6,369,110

Revenue is from ARMIS 43-01 and is in 000s.
Average Net Investment (ANI) is from ARMIS 43-01 and is in 000s.
Net Return is from ARMIS 43-01 and is in 000s.
Rate of Return is calculated by dividing Net Return by ANI.
Net Return Adjustment is calculated by subtracting actual 2004 net return from 11.25 % net return.
11.25% net return is calculated by multplying ANI by 11.25%.
Income Tax Adjustment is calculated by multiplying Net Return Adjustment by 64%.
64% is calculated by summing ARMIS 43-01 federal and state income taxes and dividing by net return
Revenue Adjustment is the sum of the Net Return and Income Tax Adjustments.

EXHIBIT C

Components of a Forward-looking Cost Study for Special Access Services

The incumbent local exchange carrier ("LEC") should conduct a forward-looking cost study for special access services. The incumbent LEC is the predominant provider of special access services and has the data necessary to perform a cost study at the individual rate element level for each type of special access service in its access tariff.

A forward-looking cost study for special access services should identify the quantities, types and amounts of investment and expenses the carrier would expect to incur for each rate element. The investments and expenses for each rate element should be based on the most efficient technology currently available for each special access service. Cost characteristics for each rate element should be developed based on current network facility and wire center configurations. The carrier should explain why the technology and cost characteristics are appropriate for each element.

- Investment: The cost study should identify each amount and type of investment that is necessary to provide each rate element. The capital cost for each rate element should be computed based on the investment items for that rate element. The carrier should use economic depreciation rates appropriate for each class of plant, should use 11.25% as the cost of capital, and should calculate taxes based on current tax codes.

- Expenses: The cost study should show the amount and type of expenses the carrier expects to incur in connection with provisioning and maintaining each rate element. Expenses should be based on work functions that are directly attributable to a particular rate element. Expenses that are not directly attributable to a particular rate element should not be included in the cost study.

Since special access services in many instances use the same network structures such as buildings, huts, enclosures, poles, conduits, cable sheaths, motor vehicles, and computer systems as do non-special access services provided by the carrier, the study should reflect the benefits that these economies provide to the carrier. Only the costs of the portion of these support structures and systems that are used by special access services should be included in the cost study. The carrier should quantify common costs separately from other costs and provide information to support any allocation to special access services.

A special access cost study at the rate element level will allow the Commission to evaluate costs by type of service, volume, term commitment and capacity levels, as well as the profit margin that can be expected from each rate element. Based on its evaluation of the initial cost data, the Commission could accept the cost data as filed or require the carrier to file modifications to the cost data. After the cost data have been finalized, the Commission may determine that the prices for special access services should be adjusted. If the Commission makes that determination, any adjustments to the special access prices that occur as a result of this cost submission should be based on these costs.